

HAWAII ADMINISTRATIVE RULES

TITLE 16

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

CHAPTER 26

EXAMINATION AND OFF-SITE MONITORING OF  
FINANCIAL INSTITUTIONS

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SUBCHAPTER 1

GENERAL PROVISIONS

§16-26-1 Objectives. The objective of this chapter is to set forth the policies of the division of financial institutions with respect to examination priorities, frequency, scope, and procedures. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-2 Definitions. Definitions are listed in alphabetical order. As used in this chapter:

"Affiliate" means any corporation, partnership, venture, association, or other similar organization which is a holding company of a financial institution; a subsidiary of a financial institution; or which has common ownership, common directors, or common control with a financial institution.

"Commissioner" means the commissioner of financial institutions, the official responsible for licensing, examining, and supervising state-chartered financial institutions.

"Division" means the division of financial institutions, department of commerce and consumer affairs, State of Hawaii.

"Examination" means the periodic on-site review and evaluation of the condition of a financial institution which is conducted in accordance with designated policies and procedures.

"FDIC" means the Federal Deposit Insurance Corporation, which provides insurance on deposits to commercial banks, savings banks, and industrial loan companies. The FDIC has primary federal supervisory authority over insured state banks that are not members of the federal reserve system.

"FFIEC" means the Federal Financial Institutions Examination Council, the interagency body which prescribes uniform principles, standards, and reporting

forms for the federal examination and supervision of insured depository institutions, bank holding companies, and savings and loan holding companies. The council has five members: the comptroller of the currency, the chairman of the Federal Deposit Insurance Corporation, a member of the board of governors of the federal reserve system, the chairman of the Federal Home Loan Bank Board, and the chairman of the National Credit Union Administration.

"FHLBB" means the Federal Home Loan Bank Board, the federal regulatory agency for savings and loan associations and savings banks. Through the Federal Savings and Loan Insurance Corporation (FSLIC), it provides deposit insurance to federal savings and loan associations and savings banks, and to many state-chartered institutions, including all Hawaii-chartered savings and loan associations.

"Financial institution" or "institution" means a state-chartered financial institution including a bank, foreign bank representative office or agency, trust company, savings and loan association, industrial loan company, or credit union. The term shall also encompass the Thrift Guaranty Corporation of Hawaii.

"Holding company" means a corporation, partnership, venture, association, or other similar organization which has majority ownership or control of a financial institution.

"NASCUS" means the National Association of State Credit Union Supervisors, the trade association of state officials charged with regulatory oversight of credit unions.

"NCUA" means the National Credit Union Administration, the federal agency that charters, insures, and supervises federal credit unions. Through the National Credit Union Share Insurance Fund, the NCUA provides deposit insurance to federal credit unions and to many state-chartered credit unions, including all Hawaii-chartered credit unions.

"Off-site monitoring" means the systematic method of tracking the financial condition of institutions between examinations by use of trends, ratios, and comparisons with peer group performance.

"Subsidiary" means a corporation, partnership, venture, association, or other similar organization of which majority ownership or control is held by a financial institution.

"Visitation" means an examination of an institution for a specific or limited purpose. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-3 Examination priority. The division's priority shall be the effective examination and supervision of those financial institutions requiring special supervisory attention; provided that each institution shall be examined at least once every eighteen months unless otherwise provided by law. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-4 Purpose of examination. (a) Disclosure of any information related to an examination of an institution is prohibited by statute, but public knowledge of the examination process should promote confidence in the integrity of the financial system and in individual institutions.

(b) The examination is designed to determine the financial condition of the institution, to evaluate the safety and soundness of its operations, to evaluate its management, and to determine compliance with applicable laws and rules. It is aimed at early detection of adverse trends and problems, so as to allow time for remedial action to be taken to correct unsafe and unsound practices or violations of laws and rules.

(c) The examination provides the commissioner with an understanding of the nature, relative seriousness, and ultimate cause of an institution's problems and provides the factual foundation on which to order corrective actions or measures. The examination, therefore, plays a key role in the supervisory and enforcement process.

(d) The examination does not serve the function of an audit. The examiner performs an evaluation function, rating capital adequacy, asset quality, management, earnings, and liquidity. The examiner accepts and relies on an institution's records and on statements and information provided by its employees, officers, and directors, and does not independently verify matters disclosed on an institution's books and records.

(e) The examination is not undertaken for the detection of fraud, nor is its sole or primary purpose to assure the complete correctness or appropriateness of records. Nevertheless, where deemed appropriate, in those cases where the examiner in charge perceives the need, the examination branch chief may make the determination to expand the scope of an examination to include the use of certain audit techniques and procedures and shall notify the deputy commissioner in writing of the expansion of the examination scope. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-14, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-5 Purpose of visitation. (a) The purpose of a visitation may include one or more of the following:

- (1) Determination of an institution's progress in complying with requirements of a formal corrective order or memorandum of understanding;
- (2) Determination of the reasons for an apparent adverse situation revealed by off-site review;
- (3) Determination of an institution's progress in improving the quality of its assets or correcting other deficiencies, since the last examination or visitation; or
- (4) Determination of the condition of an institution that is newly chartered, recently converted from a federal charter, or has recently undergone a change in management or control.

(b) When circumstances warrant, a visitation may be expanded into an examination. A visitation by federal regulators may be accepted in lieu of a visitation by the division, as deemed appropriate by the commissioner. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-6 Coordination with federal authorities. (a) Every effort shall be made to conduct joint examinations and visitations with federal authorities, so that regulatory resources may be maximized and duplication of effort may be minimized.

(b) The scope and frequency of examinations and visitations conducted by the division, shall not be governed by the needs of federal authorities, availability of federal personnel, or the requirements of federal laws or rules. Where circumstances make it impossible to conduct a joint examination within the eighteen-month period or other period provided by law, the division shall conduct an independent examination. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-7 Uniform financial institutions rating system. (a) The division adopts the "Uniform Financial Institutions Rating System" (UFIRS), which was issued and recommended by the Federal Financial Institutions Examination Council on November 21, 1979. The rating system reflects in a comprehensive and uniform fashion an institution's financial condition, compliance with laws and

regulations, and overall operating soundness. Its primary purpose is to help identify those institutions whose financial, operating, or compliance weaknesses require special supervisory attention or warrant a higher than normal degree of supervisory concern.

- (b) The uniform rating of institutions will ensure that:
  - (1) The degree of supervisory attention and the type of supervisory response are based upon the severity and nature of an institution's problems;
  - (2) Supervisory attention and action are, to the extent possible, administered uniformly and consistently, regardless of the type of institution or the identity of the regulatory agency; and
  - (3) Appropriate supervisory action is taken to address those institutions whose problems entail the greatest potential for hardship or inconvenience to depositors, borrowers, or the public; or those institutions whose potential weaknesses would most seriously disrupt the proper and efficient functioning of the financial system.
- (c) In accordance with the UFIRS, each institution shall be assigned a uniform composite rating based on an evaluation of pertinent financial and operational standards, criteria, and principles. This overall rating is expressed through use of a numerical scale of "1" through "5" in ascending order of supervisory concern. Thus, "1" represents the highest rating and, consequently, the lowest level of supervisory concern; "5" represents the lowest rating and, therefore, the highest degree of supervisory concern. The uniform composite rating shall be contained in the report of examination and shall be deemed confidential, pursuant to section 401-14, HRS. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-14, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

## SUBCHAPTER 2

### EXAMINATION FREQUENCY

§16-26-14 Examination frequency. (a) The division's priority shall be the effective examination and supervision of those institutions requiring special supervisory attention.

(b) Each institution shall be examined at least once every eighteen months unless otherwise provided by law. If an additional examination within the eighteen-month interval is deemed necessary, the commissioner may order the examination to be conducted. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8,

406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-15 Institutions assigned a uniform financial institutions rating of "1" or "2". (a) Each institution assigned a UFIRS composite rating of "1" or "2" is to be examined as deemed necessary with a maximum permissible interval between examinations of eighteen months.

(b) At least one visitation shall be performed in each twelve-month period during which an examination is not conducted. An off-site review may be substituted for a visitation if no adverse factors or trends are noted in the off-site review.

(c) Additional examinations or visitations may be conducted when it is believed that the condition of an institution may have deteriorated or may have been affected adversely. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-16 Institutions assigned a uniform financial institutions rating of "3". (a) Each institution assigned a UFIRS composite rating of "3" is to be examined at least once every twelve months. This interval may be extended up to every eighteen months when a longer interval is deemed appropriate. Acceptable reasons for extending an interval would include, but not be limited to: compliance with enforcement actions, favorable financial trends, and satisfactory improvement noted from meetings with the institution's management, visitations, progress reports, or other sources of information.

(b) At least one visitation shall be performed in each six-month period when an examination is not conducted. An off-site review may be substituted for a visitation if no additional adverse factors or trends are noted in the review.

(c) Additional examinations or visitations of such institutions are encouraged when deemed necessary. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-17 Institutions assigned a uniform financial institutions rating of "4" or "5". (a) Each institution assigned a UFIRS composite rating of "4" or "5" shall be examined at least once every twelve months.

(b) Additional examinations or visitations to monitor progress or to prevent deterioration should be performed when deemed necessary. At a minimum, one visitation shall be performed in each three-month period when an examination or other appropriate supervisory activity is not conducted. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-18 Newly chartered institutions. Each newly chartered institution shall be examined within the first twelve months of operation. In addition, as time and resources of the division allow, at least one visitation is to be performed within the first sixty days and one hundred-twenty days, respectively. Subsequent to the first examination and through the third year of operation, at least one visitation shall be performed in each twelve-month period during which an examination is not conducted. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-19 Institutions converting from a federal charter. Each institution converting from a federal charter to a state charter shall be examined within twelve months of the conversion if the institution was previously assigned a UFIRS composite rating of "3", "4", or "5" by the applicable federal regulatory agency. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-20 Institutions which have had a change of control. (a) Each institution in which there has been a change of control in ownership or management shall be examined within the first twelve months of the change, unless satisfactory financial and managerial records of performance are demonstrated by the new owners or managers in the interim period.

(b) A visitation may be conducted within ninety days of the date the change in control became operational, then quarterly thereafter until the first



examination. Subsequent to the first examination and through the third year from the change of control, at least one visitation may be performed in each twelve-month period during which an examination is not conducted. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

### SUBCHAPTER 3

#### EXAMINATION SCOPE AND FORMAT

§16-26-26 Examination scope. (a) The examination may be general in scope. Examiners may employ detailed work programs, procedures, and questionnaires to review every aspect of an institution's corporate affairs. The five key performance standards are: capital adequacy, asset quality, management competency, earnings, and liquidity. Examiners may also conduct specialized examinations which emphasize close scrutiny of specific areas of an institution's operations and minimize coverage in other areas, depending on an institution's operating and supervisory history. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

§16-26-27 Examination format and procedure. (a) Examinations of banks shall be conducted in accordance with the "FDIC Division Of Bank Supervision Manual Of Examination Policies."

(b) Examinations of foreign bank agencies shall be conducted in accordance with the "FFIEC Revised Uniform Report Of Examination For Branches And Agencies Of Foreign Banking Organizations" (FFIEC 005) and related instructions.

(c) Examinations of trust companies shall be conducted by reference to the "FDIC Manual Of Trust Examination Policies," or the "Comptroller's Handbook For National Trust Examiners," as may be applicable to operations of trust companies generally.

(d) Examinations of savings and loan associations shall be conducted in accordance with the "FHLBB/OES Manual Of Examination Objectives And Procedures," and related instructions.

(e) Examinations of FDIC-member industrial loan companies shall be conducted in accordance with the "FDIC Division Of Bank Supervision Manual Of Examination Policies."

(f) Examination of industrial loan companies that are not FDIC members shall be conducted in accordance with the "Division of Financial Institution Manual Of Examination Policies For Non-thrift Industrial Loan Companies."

(g) Examination of credit unions shall be conducted in accordance with the "NASCUS/NCUA Examiner's Guide For The Core Examination Program." [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

#### SUBCHAPTER 4

#### SPECIALTY EXAMINATIONS

§16-26-33 Examination of holding company, subsidiary, or affiliate.

(a) The division shall review and rely on holding company inspection reports prepared by the federal regulatory agencies in determining the frequency or scope of an examination and the UFIRS composite rating of the subsidiary institution.

(b) When the operations of a holding company, subsidiary, or affiliate may have a substantial adverse impact on an institution, an examination of the holding company, subsidiary, or affiliate may be conducted. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18, 403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

#### SUBCHAPTER 5

#### OFF-SITE MONITORING

§16-26-39 Off-site monitoring. Off-site monitoring of institutions involves the systematic review of financial reports, audit statements, and other reports requested on an ad hoc basis. The principal purpose of off-site monitoring is to identify institutions that appear to evidence unusual conditions. Off-site monitoring complements, but does not substitute for, the examination of institutions, and may trigger an early examination or highlight areas in which special attention must be given. [Eff 8/13/87] (Auth: HRS §§401-3, 401-18,

403-8, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-3, 401-4, 401-6, 401-7, 401-15, 403-8, 403-14, 403-16, 403-173, 405-34, 406-39, 407-95, 407-101, 407-102, 408-22, 408A-24, 410-25)

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Chapter 16-26, Hawaii Administrative Rules, on the Summary Page dated July 17, 1987, was adopted on July 17, 1987, following a public hearing held on July 15, 1987, after public notice was given in The Honolulu Advertiser and the Honolulu Star-Bulletin on June 24, 1987.

The adoption of chapter 16-26 shall take effect ten days after filing with the Office of the Lieutenant Governor.

/s/ Donna Tanoue

DONNA TANOUE

Commissioner of Financial Institutions

APPROVED AS TO FORM:      Date 7/24/87

/s/ Winfred K. T. Pong

Deputy Attorney General

APPROVED:      Date 7/24/87

/s/ Robert A. Alm

ROBERT A. ALM

Director of Commerce and Consumer Affairs

APPROVED:      Date 8/3/87

/s/ John Waihee

JOHN WAIHEE, Governor  
State of Hawaii

August 3, 1987

Filed

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Adoption of Chapter 16-26  
Hawaii Administrative Rules

July 17, 1987

SUMMARY

Chapter 16-26, Hawaii Administrative Rules, entitled "Examination and Off-Site Monitoring of Financial Institutions", is adopted.

THIS MATERIAL CAN BE MADE AVAILABLE FOR INDIVIDUALS WITH SPECIAL NEEDS IN BRAILLE, LARGE PRINT OR AUDIO TAPE. PLEASE SUBMIT YOUR REQUEST TO THE COMMISSIONER OF FINANCIAL INSTITUTIONS AT (808) 586-2820.

DIVISION OF FINANCIAL INSTITUTIONS  
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS  
STATE OF HAWAII

Chapter 16-26, Hawaii Administrative Rules, which was adopted on July 17, 1987 and became effective on August 13, 1987, was the subject of another opportunity to provide public comment. A public hearing was held on September 12, 1989 at 8:00 am.m in the Kuhina Nui Room, Kamamalu Building, Department of Commerce and Consumer Affairs. Public notice of the hearing was published on August 2, 1989 in The Honolulu Advertiser, Honolulu Star-Bulletin, West Hawaii Today, The Maui News, The Hawaii Tribune-Herald, and the Garden Island.

After review of the comments submitted, the Commissioner of Financial Institutions determined that the rules should remain as originally adopted.

/s/ Clifford K. Higa  
Clifford K. Higa, Commissioner  
Division of Financial Institutions  
Department of Commerce and Consumer Affairs

September 18, 1989  
Date